North Dakota Law Review

Volume 28 | Number 2 Article 3

1952

Negotiable Instruments - Limiations on Actions - The Statute of Limitations Applied to Actions against Drawers of Bank Drafts

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ousted of this jurisdiction by defendant's incidental claim that a certain patent is invalid.[53]

Whatever the state court's attitude is toward its diminishing jurisdiction, the federal tendency, it seems clear, is toward the position occupied by Judge Clark. Consistent with this is a recent remedial statute,[54] purporting to extend the doctrine of the *Hurn* case. What effect, if any, this statute will have upon the courts must remain problematical because in the *Kleinman* case, where the statute was sought to be applied, the court distinguished the case and decided on other grounds.[55] It is to be here noted that the suggested changes embodied in the remedial statute and cogently asserted by Judge Clark are pointed in the right direction, toward much-needed judicial economy for both the litigant and the court, toward accelerated appellate process and toward greater liberality in pleading. They cannot, however, of themselves outweigh the necessity for retaining wherein possible the constitutional division of jurisdiction between federal and state courts. The Second Circuit's tenacious resistance to the extension of the pendent jurisdiction rule, which can only be made at the expense of state court jurisdiction, is in this respect a healthy safeguard.

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NEGOTIABLE INSTRUMENTS — LIMITATIONS ON ACTIONS — THE STATUTE OF LIMITATIONS APPLIED TO ACTIONS AGAINST DRAWERS OF BANK DRAFTS. — Bank drafts are demand instruments drawn by one bank upon another. They are drawn on funds deposited in the drawee bank in the same manner as ordinary bank checks, drawn by individuals. These drafts are used for the immediate transfer of funds by the issuing bank or by individuals or corporations who purchase the drafts.

When a bank issues a draft drawn on a correspondent bank, it immediately credits the account of the drawee for the amount of the draft. The drawee bank, on the other hand, does not charge the account of the drawer until the draft is presented and paid.

53. Pratt v. Paris Gas Light & Coke Co., 168 U.S. 255 (1897).

54. 62 Stat. 931 (1948), 28 U.S.C. §1338 (b) (Supp. 1948): "The district courts shall have original jurisdiction of any civil action asserting a claim of unfair competition when joined with a substantial and related claim under the copyright, patent or trademark laws."

55. The court held that there was in fact no unfair competition, the niceties of which are discussed elsewhere in this note, and therefore the statute, especially restricted to case of unfair competition joined with patent, copyright or trademark infringement, did not apply.

This means that during the period of time in which the draft remains unpaid by the drawee, there is a discrepancy between the asset account of the drawer and the deposit account of the drawee for the amount of that draft. A considerable number of these drafts are never presented for payment. It is natural that issuing banks would like to charge off these unpaid drafts after a certain period of time and clear their books of these items. This desire is due to the fact that it becomes impractical to keep records which have reached a certain age, that the unpaid drafts cause increasing discrepancies in accounts with correspondent banks, and that old unpaid items call for continued, troublesome, and often inaccurate accounting and reconciling.

But there is a natural reluctance to charge off these unpaid drafts unless the drawer is certain that no legal claim may be based upon them in the future. The best assurance of this would be the operation of the statute of limitations[1] to bar the claim of the holder of a draft against the drawer of that draft after the expiration of a certain period of time. It is the purpose of this note to examine the question of whether the drawer bank would be protected in such a manner.

The Nature of the Bank's Liability

Before the pursuit of the main inquiry as to the application of the statute of limitations it will be necessary to determine whether the fact that a bank draft is issued by a *bank* will cause different rules to be applied than those ordinarily applied to negotiable instruments.

There have occasionally been statements which might raise the question of whether bank drafts were in the nature of deposits in the drawer bank.[2] If they were deposits the consequence would seriously affect this problem. It is generally conceded that the statute of limitations does not begin to run upon a bank deposit until a demand has been made against the bank.[3] This would prevent the drawer bank from taking advantage of the statute

1. A typical statute of limitations is the North Dakota statute which provides that: "The following actions must be commenced within six years after the cause of action has accrued: 1. An action upon a contract, obligation, or liability, express or implied . . ." N.D. Rev. Code §28-0116 (1943).

2. Britton, Bills and Notes 776 (1943) (bank instruments serve, in a sense, the same purpose as deposits). Bank drafts are insured by the Federal Deposit Insurance Corporation in the same manner as regular deposits. Federal Deposit Insurance Act, Related Laws and Rules and Regulations §326.1 (a) (1951). This regulation was issued by the Board of Directors of the F.D.I.C. in pursuance to a statute, 12 U.S.C.A. §1813 (1) (Supp. 1951).

3. *In re McKeyes'* N.W.state, 315 Mich. 369, 24 N.W.2d 155 (1946); Girard Bank v. Bank of Penn Township, 39 Pa. 92 (1861).

of limitations until the holder of the draft had made a demand, the demand had been refused, and the statutory period of limitations had run after the demand and refusal.[4]

But there is apparently no legal authority for the proposition that drafts are deposits, although this appellation has been applied by courts to several other types of negotiable instruments issued by banks.[5] However, cashier's checks, certified checks and certificates of deposit are direct liabilities of the issuing bank and the accounting methods used in most banks treat these instruments, which, unlike drafts, are often not intended for immediate circulation, as deposit liabilities, while bank drafts are mere secondary liabilities and are never accounted for as deposit liabilities, but upon issue are deducted from asset accounts representing balances with correspondent banks.[6]

It has generally been ruled that in the eyes of the law, bank drafts are the same as ordinary checks, drawn by individuals,[7] and that they are to be treated as checks for the application of the statute of limitations.[8] In this note cases applying the statute of limitations to bank drafts and those applying the statute to ordinary bank checks will be considered together.

The Statute of Limitations

Most statutes of limitations[9] provide that the actions affected must be commenced within a certain time *after the cause of actions has accrued.* It is immediately apparent that it is difficult logically to apply this statute in favor of the drawer of an outstanding bank draft. The reason for this is that under the Uni-

4. Several states have passed statutes providing that abandoned deposits in banks escheat to the state after a certain period of time. See, for example, Minnesota Stat. Ann. §48.521-528 (1945). This statute was applied in State v. Northwestern Nat. Bank of Minneapolis, 219 Minn. 471, 18 N.W.2d 569 (1945) to certificates of deposit and cashier's checks issued by a bank.

5. State v. Northwestern Nat. Bank of Minneapolis, *supra* note 4 (certificates of deposit). *See* Lummus Cotton Gin Co. v. Walker, 195 Ala. 552, 70 So. 754, 756 (1916) (applied to cashier's checks and certified checks stating: ". . . the deposit represented by the check passes to the credit of the checkholder, who is thereafter a depositor to that amount."

6. Other difficulties might arise. North Dakota, for example, has a statute in its code chapter entitled "Time for Commencing Actions" which states: "This chapter does not affect actions to enforce the payment of bills, notes or other evidence of debt, issued by moneyed corporations, or issued or put in circulation as money." N.D. Rev. Code §28-0135 (1943). Although this provision could be construed as applying to drafts, its obvious purpose is to apply to instruments intended to circulate as money, such as bank notes. No cases upon this statute have been decided, and it could prove to be a real obstacle to the application of the statute of limitations to bank drafts in North Dakota.

7. See First Nat. Bank v. Farmers' State Bank, 120 Kan. 706, 244 Pac. 1039, 1040 (1926).

8. See Wrigley v. Farmers' and Merchants' State Bank, 76 Neb. 862, 108 N.W. 132 (1906).

9. See, for example, the North Dakota statute, *supra* note 1.

form Negotiable Instruments Law[10] the cause of action against the drawer of a three party instrument does not accrue until the instrument has been presented for payment to the drawee and payment has been refused. If the statute is to be applied in favor of the issuer of a bank draft, a meaning not apparent upon the face of the statute must be applied.

This problem is a part of a somewhat broader question as to the application of the statute of limitations to any type of contract in which a demand by the creditor is necessary before he has a cause of action against the debtor. In any such situation the statute of limitations would not appear to apply until an actual demand for payment has been made. But to construe the statute narrowly would defeat its purpose, which is to bar the prosecution of stale claims. Most courts faced with this problem in contract cases have decided that the statute of limitations would apply, regardless of whether demand has been made, usually upon the theory that the demand must have been made by the creditor within a reasonable time and that the reasonable time was the period of the statute of limitations. After the expiration of this period the creditor had no rights against the debtor.[11] Professor Williston [12] quotes with approval *Campbell v. Whoriskey* [13] to the effect that when a demand is necessary to perfect a cause of action it must be made within a reasonable time, that the nature of the contract determines what is a reasonable time, but that when there is nothing to indicate that a demand is to be made quickly or to be delayed, the period of the statute of limitations should be treated as the time within which a demand must be made. The reasoning in this type of case forms a background for discussion of the problem in relation to demand negotiable instruments.[14]

In the case of demand notes the statute of limitations is usually

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10. 5 U.L.A. Part 2 §70 (1943), N.D. Rev. Code §41-0701 (1943).

11. Caner v. Owners' Realty Co., 33 Cal. App. 479, 165 Pac. 727 (1917). *See* Bannitz v. Hardware Mut. Casualty Co., 219 Minn. 235, 17 N.W.2d 372, 373 (1945) (parties contemplated that demand was to be postponed indefinitely).

12. 6 Williston, Contracts 5720 (Rev. Ed. 1938).

13. 170 Mass. 63, 48 N.E. 1070 (1898).

14. Gossard v. Gossard, 149 F.2d 111, 113 (10th Cir. 1945) discussed the reasoning in these demand contract cases as follows: "Under one line of authority, the statute of limitations begins to run upon the making of a demand within a reasonable time, or, if no demand is shown to have been made, at the expiration of such reasonable time when a demand will be presumed to have been made. Under another line of authority, it is held that the cause of action accrues for the purpose of setting the statute in motion as soon as the promisee by his own act can make the demand payable, and that on the expiration of thte statutory period thereafter without demand, the action is barred."

held to run from the date of issue of the note.[15] This is generally predicated upon the theory that a demand note is due when issued and a cause of action upon the instrument accrued in favor of the holder as soon as the note was issued.[16] If the premise that the note is due upon issue is accepted, the holdings that the statute of limitations runs from the date of issue do no violence to logic. However, in *Palmer v. Palmer*[17] where the court held that the statute of limitations had run in favor of the maker of a demand note before actual demand had been made, the court applied the theory somewhat akin to the equitable doctrine of laches, stating to support its holding that:

> "It is no stretch of language to hold that a cause of action accrues for the purpose of setting the statute in motion as soon as the creditor by his own act, and in spite of the debtor, can make the demand payable. . . . Where no delay is contemplated the rule is just and reasonable; and the presentment should be reasonably prompt, or the creditor should be subjected to the operation of the statute."[18]

The purpose sought to be effected by this theory is desirable, but the reasoning is certainly contrary to the language of the statute of limitations, seemingly applying the statute of limitations to bar an effective demand.[19]

The cases upon checks[20] and drafts introduce an element not present in the cases on ordinary contracts and demand notes. This is the necessity of presentment and demand to a third party before a right of action against the drawer arises. But the courts have applied much of the reasoning in the contract and note cases to the check[21] and draft cases.

The Supreme Court of the United States in *Merchant's Bank v. State Bank*[22] stated, "It (a bank check) is not due until payment is demanded, and the statute of limitations runs only from that

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15. Baird v. Utecht, 67 N.D. 491, 274 N.W. 513 (1937); Rohrig v. Whitney, 234 Iowa 435, 12 N.W.2d 866 (1944).

16. Shuman v. Citizens' State Bank of Rugby, 27 N. D. 599, 147 N.W. 388 (1914) (statute of limitations not involved).

17. 36 Mich. 487 (1877).

18. *Id.* at 494.

19. See Note, 22 Ore. L. Rev. 381 (1943) which suggests the somewhat awkward solution that the parties to a demand note should be presumed to intend that the maker is liable on the instrument after a reasonable period of time without demand.

20. For a collection of cases dealing with the statute of limitations in regard to checks, see note, 4 A.L.R. 881 (1919).

21. The Uniform Neg. Inst. Law §186, found in 5 U.L.A. Part 2 §186, N.D. Rev. Code §41-1703 (1943), provides that a check must be presented within a reasonable time after issue or its drawer will be discharged to the extent of loss caused by the delay. Colwell v. Colwell, 92 Ore. 103, 179 Pac. 916 (1919), held that this section applied when the action was brought within the statute of limitations, but did not operate to oppose the regular rule of the statute of limitations.

22. 10 Wall. 604, 647 (U.S. 1870).

time." But this statement was dictum and, although quoted in dicta in several cases,[23] has apparently never found support in the holding of any court as to the running of the statute of limitations.

Courts in the United States[24] have several times applied a variation of the reasoning applied in the contract cases previously discussed to cases on checks[25] and drafts. They have held that the statute of limitations begins to run upon the expiration of a reasonable time after issue of the instrument.[26]

In the case of *Dolon v. Davidson*[27] the court alternatively based its holding that the statute of limitations ran in favor of the drawer of a check upon a New York statute which stated that the statute of limitations ran in such cases from the time when the right to make the demand was complete. But the court stated that the qualifying statute was only declaratory of the law and that a drawer would be entitled to the protection of the statute of limitations without the existence of the qualifying statute, on the theory that: "the holder of a check should not be permitted to postpone indefinitely the liability of the maker, by omitting to present the check for payment."

The theory quoted in the above case, which uses the same reasoning as *Palmer v. Palmer*,[28] was enunciated more recently in relation to a suit on a bank draft in *Dean v. Iowa-Des Moines Nat. Bank and Trust Co.*[29] where it was stated that:

23. See Citizens' Nat. Bank v. First Nat. Bank, 66 Colo. 246, 182 Pac. 12 (1919); Wright v. MacCarty, 92 Ill. App. 120, 122 (1900).

24. In England the rule appears to be different. See *In re* Boyse, 33 Ch. D. 612 (1886), which held that the statute of limitations did not run in favor of the drawer of a bill of exchange until the bill had been presented for payment.

25. It may be noted that if the drawer does not have sufficient funds in the drawee bank at the time of the issuing of the check, the holder has an immediate cause of action against the drawer without the need of presentment to the drawee, and the statute of limitations runs in favor of the drawer in such a case from the date of issue of the check. Brush v. Barrett, 82 N.Y. 400 (1880).

26. Colwell v. Colwell, 92 Ore. 103, 179 Pac. 916 (1919) (the reasonable time expired at the close of the next day's business); Scroggin v. McClelland, 37 Neb. 644, 56 N.W. 208 (1893) (the instrument was a bank draft although called a check in the case).

27. 16 Misc. 316, 39 N.Y. Supp. 394, *aff'd. sub nom.* Donlon v. Davidson, 7 App. Div. 461, 39 N.Y. Supp. 1020 (1896). A recent New York case stated that the statute of limitations commenced running upon a check from the date of issue, this statement was made without comment and without mentioning the statute used in the above case. Farrell v. City of New York, 197 Misc. 1059, 98 N.Y.S.2d 56 (1950).

28. 36 Mich. 487 (1877).

29. 227 Iowa 1239, 281 N.W. 714, 290 N.W. 664 (1940). The question in this case was the operation of the statute of limitations upon a bank draft, a cashier's check, a certified check, and a certificate of deposit. In the action upon the draft it was originally held that the statute of limitations was not a defense since the cause of action had not accrued, but upon rehearing the court held that the statute of limitations was a good defense, using the reasoning quoted above. It was also held that the statute ran on the cashier's check from date of issue. The defense of the statute of limitations was not, however, applicable to the certified check and the certificate of deposit, since an actual demand was necessary to start the statute running on these instruments.

"It must be conceded that it is the general rule, that plaintiff's cause of action has not accrued so as to start the statute of limitations running, unless all the facts exist so that plaintiff can allege a complete cause of action, but there is an exception controlling in the case at bar. Namely, if the only act necessary to perfect the plaintiff's cause of action is one to be performed by the plaintiff and he is under no restraint or disability in the performance of such act, he cannot indefinitely suspend the statute of limitations by delaying performance of the act."[30]

The cases cited above and the absence of contra holding point to the fact that the courts in this country support the idea that the drawer of a check or draft, like the debtor in most other types of contracts, should be protected by the running of the statute of limitations, even though the language of the statute seems to deny such protection. However, it is submitted that the reasons given to support the desired result are mere rationalizations, and that the holdings in these cases are not based upon sound logic. There is nothing in the statute of limitations to support the idea that it will operate, even though a cause of action has not accrued, upon the expiration of a reasonable period of time, or when the creditor has it within his power to begin the accrual of the cause of action. But it is conceded that any new case decided upon one of these theories will have the support of a considerable amount of judicial precedent.

It is not the purpose of this note to suggest that one of these theories is the best, or to propose a new theory rationalizing the application of the statute of limitations. It is suggested that the confusion in reasoning may best be resolved by the passage of legislation which will modify the statute of limitations[31] so that it will apply to cases where the cause of action has not actually accrued so as to logically permit the application of the statute. Such legislation might be patterned upon the New York statute applied in *Dolon v. Davidson*[32] in favor of the drawer of a check. The essential part of this statute reads:

30. 227 Iowa 1239, 1261, 290 N.W. 664, 667 (1940). The dissent of Richards, J. to the opinion on rehearing accuses the majority of applying the doctrine of laches to a law action. This dissent is a good example of the application of strict logic to the operation of the statute of limitations in a bank draft case. See 227 Iowa 1239, 1242, 290 N.W. 664, 665 (1940).

31. There may be other solutions. For example, in 1949 a statute was passed in North Dakota which provided that no action should be brought against a bank on a debt unless demand be made in writing within six years from the contracting of the debt. N.D. Rev. Code §6-0824 (Supp. 1949). Although this statute would not affect bank drafts issued before its passage, it may well be that no remedy will be available against the drawer of a bank draft issued after the passage of the act unless a written demand is made upon the bank within six years after the draft is issued.

32. See note 27 *supra*.

> "Where a right exists, but a demand is necessary to entitle a person to maintain an action, the time within which the action must be commenced must be computed from the time when the right to make the demand is complete. . . ."[33]

But even without such legislation it may be concluded that in any action against the drawer of a bank draft [34] which is commenced later than the statutory limit for bringing contract actions after the issuance of the draft, prior judicial decisions would strongly support the defense that the statute of limitations would operate to bar the suit.

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33. N.Y. Code of Civ. Proc. §410. Stover's N.Y. Code Ann. (2d ed. 1895).

34. The proposed Uniform Commercial Code provides specifically that a cause of action against the drawer of a draft accrues upon demand following dishonor of the instrument, Uniform Commercial Code, Proposed Final Draft No. 2, Text Edition, §3-122 (3) (Spring, 1951). For a discussion of this section in relation to the statute of limitations see Tisdale, *Uniform Commercial Code-Commercial Paper, Part I*, 26 N.D. Bar Briefs 252, 270-2 (1950).